VISIT…

- Using Trailing Stops and the "3-Spread Stop Loss" Rule

Main Points:

- **Trailing Stops** defined: Once you are in a profitable trade, you should raise your stop loss to "follow" the stocks' price as it moves up. This ensures that you will take a profit from the trade and not let a winner turn into a loser.
- **Example**: You buy WCOM at 44 3/8 (putting an initial stop in at 43 15/16 using your software, or a 'mental stop' if you are highly experienced - 1+ years or more fulltime daytrading). Now, let's say WCOM ticks up to 44 5/8. You would cancel your original stop, and enter a new "trailing stop" in at , say, the point you bought in at, at 44 3/8 (or perhaps 44 1/4). Eventually, WCOM breaks through 45 and ticks up to 45 1/16th. Now, you cancel the previous stop and enter a new stop at 44 15/16 (always place your trailing stops 1/16th under whole numbers/major fractions). WCOM starts to tick down, you see a ton of sell orders hitting the bid at 45, it starts to get thinner on Level 2, now it drops to 44 15/16 and your stock is sold. You lock in a profit of 9/16th, or $56/hundred shares (so, if you were trading 500 shares your profit would be $280.) This all happens in the space of 5-20 minutes.
- **3-Spread Stop Loss Rule**: we will also see how to set your stop losses for those times that you are wrong and the trade goes against you right after you buy in. At DTU we advocate a 2-3 spread maximum stop loss. I usually use the level 2 strength within 1 spread, as confirmed by T&S and 1-minute chart, to set even closer stops for the frequent times we scalp for 3/8 - 1/2 points.
- Most books say "take small stops" without explaining the mechanics of how this works when you're using level 2 in a live trade situation. This lesson will show you step-by-step, using screen snapshots, how to set and manage your stops and trailing stops using Level 2.

Examples:

3-Spread Maximum Stop Loss on Level 2

3-Spread Stop Loss: You should set a maximum stop of 2-3 spreads for all daytrades you do. I've illustrated how this looks in the level 2 window to the right.

You buy at 11 1/16, and immediately set a stop at 10 3/4 or 10 13/16. Why the 13/16? So that you get executed before it ticks down to 10 3/4.

Remember a lot of traders don't have level 2 yet (especially good tip for cheap stocks like this one; cheap stock players tend to be undercapitalized and can't afford pro L2 data feeds etc; our advantage).

Use Level 2 to help manage your timing for entries and exits, especially for stops and split-second timing for sell orders.

Never let a daytrade go more than 3 spreads against you. If you're that wrong about it, don't let it turn into an "investment", cut it short quickly and be prepared to re-enter the trade when buyers come back in.

Notes/Exceptions for this particular trade: Usually, I'd join the bidders at 11, but I'd be unlikely to get a fill, given the strong buying (see all the 11 1/16 buys on T&S) and thin number of weak mm's on the ask.

In fact, I would be likely to buy here at 1/16 and sell if the buyers at 11 thinned out down to 2-3 participants. If I'm wrong, I can always buy back in.

As a general note, you probably wouldn't want to buy this stock now anyways, it's lunch and it's already done its "run and retracement" for now. This trade might be good for only 1/8 point here, its a low percentage trade.

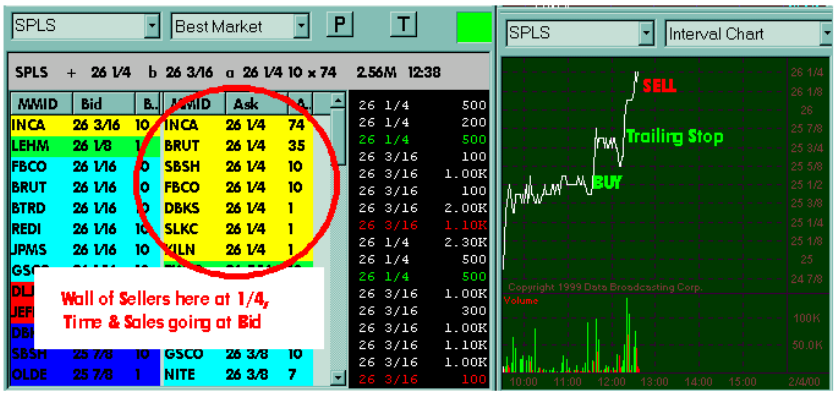
Trailing Stops and Level 2

Trail your stops roughly 3 spreads behind the current inside bid. In this case, I'd probably sell right now, since there's a "wall of sellers" and it just ran up w/declining volume in the 1-minute chart.

If I was in the trade from earlier, my trailing stop would be around 25 15/16 (again, set it 1/16th under a whole number or major fraction).

Do Not neglect to use trailing stops; they lock in your profit and keep winners from turning into losers. It's better to consistently take 1/4s, 3/8ths and 1/2's off the table, keeping 1/16th-1/4point stops than to take large hits.

Another tip: You can also set your stops using a Dollar Amount; eg I never let a stock go more than $200 against me (whatever that works out to in terms of



The trailing stop you use depends on three factors:

1) **Time of day**: use tighter stops if you are outside of "prime time", eg trading after 11:30 EST.

2) **Momentum:** If the stock is running up then ratchet up your stops faster and be prepared to sell quickly, before, the other sellers do. What goes up fast also drop fast as well.

3) **Price Levels Widths for Your Stock**: Some stocks have each level only 1-3 participants wide, others like SPLS will get as thick as 6-8 participants. In general, use a larger number of spreads (up to 5) for stocks that are trading with thinner numbers of participants at each level.

the number of stops etc.). Your stops should be "small cuts" you take on the way to successful, larger trades.

Get used to stopping out early, stopping out often. The extra commissions are a small percentage compared to loss of bigger chunks of your trading capital.

I used to get stopped out from 60-80% of the time; even on a great day I now seldom do better than 70% right on my trading calls; it's the money management piece of it that keeps it in the green and keeps it profitable.

Remember: You can make a living daytrading by being right only 20% of the time. Keeping tiny frequent stops and trailing your winners up to lock in profits is the key to success in daytrading.

Avoid the temptation to buy bottoms and short tops all the time; it's like fishing. Wait instead for Volume Reversals and pivots, using a stop at the previous low (for bottomfishing) or previous top (for shorting).

Stocks like WCOM and DELL are very difficult to daytrade since everyone's scalping them all the time for a living; try trading easier stocks at first.